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Transporters and other interested
parties

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Dear Colleague,

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Modification proposal 0046 'Extension of the sunset clauses for registration of capacity at NTS exit points'

Ofgem¹ has considered the issues raised in the modification report in respect of Uniform Network Code (UNC) modification proposal 0046 '*Extension of the sunset clauses for registration of capacity at NTS exit points*' and, having regard to the principal objective and statutory duties of the Authority², has decided to direct the relevant gas transporters to implement modification proposal 0046.

Background to the proposal

On 8 September 2005 National Grid National Transmission System³ (NTS) raised modification proposal 0046 '*Extension of the sunset clauses for registration of capacity at NTS exit points*'. This modification proposal outlines details of a proposed process through which firm capacity (held by NTS direct connects (DCs)) and NTS offtake capacity (held by Distribution Networks (DNs)) could be allocated for the period 1 October 2008 to 30 September 2010. In particular, a number of changes were proposed to the firm capacity application process and to the NTS offtake capacity registration process.

Authority decision on enduring offtake arrangements

At its meeting of 23 June 2005, the Authority reviewed its previous decision to require the implementation of the NTS enduring offtake arrangements on or before 1 September 2005. The Authority concluded that the enduring offtake arrangements remain an important aspect of the regulatory, commercial and operational framework necessary to protect customers' interests in a divested industry structure. However, the Authority decided that further time should be allowed for consultation on the development of the enduring offtake arrangements with a view to their implementation from September 2007 to allow the allocation of offtake rights for the period from 1 October 2010 onwards.

The reasons for the Authority decision are outlined in detail in an open letter published on 24 June 2005.⁴ Given this decision, it has been necessary to consider the arrangements for the allocation of NTS offtake rights to NTS connectees (that is the DN's and NTS DCs),

¹ Ofgem is the Office of the Gas and Electricity Markets Authority. The terms 'Ofgem' and 'the Authority' are used interchangeably in this letter.

² Set out in Section 4AA of the Gas Act 1986, as amended.

³ Transco plc changed its name to National Grid Gas plc on 10 October 2005. This document uses the name National Grid Gas (NGG), throughout the document including where referring to NGG's predecessor organisations.

⁴ 151/05, Ofgem open letter on enduring offtake arrangements, June 2005.

for the period between 1 October 2008 (the time at which the interim arrangements end) and 1 October 2010 (the time at which the enduring arrangements begin) (the "transitional period").

In summary, the Authority concluded that a revision of the timetable would be consistent with the principles of better regulation and would also provide additional time for it to consider a number of important interactions between the NTS offtake arrangements and the NTS entry capacity regime as part of the forthcoming transmission price control review.

Related changes

Related to Modification Proposal 0046, changes have been proposed to a number of supporting documents as part of the transitional arrangements. Specifically, National Grid NTS has released consultations on proposed changes relating to:

- ◆ the Incremental Exit Capacity Release (IExCR) Methodology Statement which currently only outlines the manner in which capacity is released during the interim period, i.e. gas year ending 30 September 2008;
- ◆ Standard Condition 4B statement of "Principles and Methods to be used to Determine Charges for National Transmission System Connection Services" to introduce the concept of an Advanced Reservation of Capacity Agreement (ARCA) for DNs; and
- ◆ a proposed generic form of ARCAs applicable to DNs, based upon that which is currently applicable in respect of NTS DCs.

The consultation on these supporting documents closed on 22 September 2005. However, on 25 November 2005, National Grid NTS released a further consultation on proposed changes to the IExCR⁵. This consultation closed on 23 December 2005.

National Grid NTS submitted a consultation report on the IExCR to the Authority on 4 January 2006. However, the Authority decided to veto the changes proposed to the IExCR on 12 January 2006. The open letter outlining the reasons for this decision can be found on the Ofgem web-site⁶. On 18 January 2006, National Grid NTS submitted a revised IExCR to the Authority. The Authority has decided not to veto the changes proposed in this revised IExCR and will shortly issue an open letter in this regard. In addition, on 14 December 2005 National Grid NTS issued a further consultation on the terms of the ARCA applicable to DNs and DCs. This consultation closed on 13 January 2006.

Proposals on incentives for the transitional period

On 21 September 2005 Ofgem published a document consulting on its initial proposals for incentives within the transitional period.⁷ Following consideration of the views expressed by respondents to the initial proposals document, on 25 November 2005, Ofgem published its final proposals on transitional incentives.⁸ In this document, Ofgem did not propose to extend all of the incentive schemes currently applying to National Grid NTS and the DNs into the transitional period at this time. In particular:

⁵[http://www.nationalgrid.com/uk/Gas/OperationalInfo/operationaldocuments/Incremental + Entry + Capacity + Release + Model + and + Statement/](http://www.nationalgrid.com/uk/Gas/OperationalInfo/operationaldocuments/Incremental+Entry+Capacity+Release+Model+and+Statement/)

⁶ www.ofgem.gov.uk (area of work: Gas Governance)

⁷ *Initial proposals on transitional incentives supporting the offtake arrangements*, Ofgem, September 2005

⁸ *Final proposals on transitional incentive schemes and formal licence consultation under section 23 of the Gas Act and paragraph 3(a) of Standard Special Condition A2*, Ofgem, November 2005

- ◆ the “greater than 15 day interruptions” DN incentive will be reviewed as part of the DN interruption reforms project; and
- ◆ the scope, form and duration of the NTS exit incentives will be defined at the time of the next Transmission Price Control Review (TPCR) (to be implemented in April 2007).

However, Ofgem considered it necessary to specify incentives for the DN for the duration of the transitional period to mitigate a tendency for DN to overbook NTS exit rights. Ofgem proposed a single “sliding scale” incentive mechanism for each DN for the duration of the transitional offtake arrangements, with the specification of a single cost performance measure and target (for each DN zone) covering both NTS offtake (flat) capacity and NTS offtake (flexibility) capacity, as well as a defined cap, collar and sharing factors.

Ofgem has received a number of responses to the final proposals on transitional incentives, and, following consideration of these responses, is minded to direct the relevant changes to the NTS and DN licences in the near future.

The Modification Proposal

The modification proposal is to make a number of changes to the UNC, as outlined below.

Firm capacity applications

National Grid NTS proposed that the current arrangements for firm capacity applications be extended to continue until 30 September 2010. According to the proposer, this will allow shippers to continue to request increases in firm capacity or the redesignation of an interruptible supply point as firm for utilisation over two further gas years.

NTS offtake capacity registration process

National Grid NTS proposed to extend the current arrangements such that Distribution Network Operator (DNO) users are able to apply on an annual basis for initial amounts of NTS offtake capacity at each of their NTS/LDZ offtake beyond 30 September 2008. National Grid NTS proposed that:

- ◆ for 2005 the application window for capacity requests for gas year 2008/09 would be the first two weeks after implementation of modification proposal 0046; and
- ◆ for 2006, DNO users would apply for initial amounts of NTS offtake capacity for gas year 2009/10 during the normal June/July application window.

In addition, under modification proposal 0046, amendments to previously allocated NTS offtake capacity amounts are proposed to continue on the same basis as the current arrangements over the transitional period. Table 1, below, outlines National Grid NTS’s proposed timetable for the NTS offtake capacity registration process over the transitional period, as outlined in modification proposal 0046.

National Grid NTS stated that it would make determinations of any requests to amend capacity allocations in accordance with the IExCR Methodology Statement. As noted above, National Grid NTS has consulted on a number of changes to the current interim IExCR proposing, among other changes, to extend its applicability beyond 30 September 2008 up to 30 September 2010.

Under modification proposal 0046, National Grid NTS would inform DNO users whether their application for amendment to their allocated capacity or an initial capacity amount has been accepted in whole or in part, or rejected, through issuing a revised Offtake

Capacity Statement (OCS). For 2005, National Grid NTS proposed that applications for initial capacity amounts for 2008/09 are responded to within six weeks of the implementation of modification proposal 0046. For years 2006 to 2009, National Grid NTS proposed that the OCS is issued by 30 September each year.

In addition, National Grid NTS proposed that Assured Offtake Pressures are set for each NTS/LDZ offtake at the same level as specified in the previous gas year, subject to any revisions agreed in accordance with existing mechanisms under the Transportation Principal Document (TPD).

Table 1 Proposed timetable for NTS offtake capacity registration over the transitional period

Application Window	Requests for Amended Capacity – Relevant Gas Years	Requests for Initial Capacity – Relevant Gas Year	National Grid NTS Response to Capacity Request
Two weeks after implementation of Proposal		2008/09	Six weeks after implementation of Proposal
June/July 2006	2006/07 2007/08 2008/09	2009/10	30 September 2006
June/July 2007	2007/08 2008/09 2009/10		30 September 2007
June/July 2008	2008/09 2009/10		30 September 2008
June/July 2009	2009/10		30 September 2009

National Grid NTS also recognised that shipper users at NTS supply points and NTS connected system exit points (CSEPs) can only formally register NTS exit capacity requirements under the current UNC provisions for shorter periods, and closer to the gas flow day compared to the proposals set out above for DNs. However, National Grid NTS stated that shipper users and/or developers are able to “reserve” future capacity requirements that would require investment in the NTS via the execution of an ARCA.

Respondents’ views

Thirteen responses were received in relation to modification proposal 0046. Nine respondents supported the modification proposal, and four respondents expressed their qualified support.

A number of respondents considered that this modification proposal is necessary following the Authority’s decision to delay the enduring offtake arrangements. Some respondents stated that this modification proposal represents a pragmatic solution to the arrangements for the transitional period.

Sunset clauses

A number of respondents stated their preference for adopting the current offtake arrangements, which would be extended by this modification proposal, as a basis for developing the enduring offtake arrangements.

One respondent considered that the interim arrangements are valid for an extended period, providing the industry with a period of stability and permitting emphasis to be placed on developing the long-term, enduring arrangements. Another respondent considered that the drafting should avoid sunset clauses, and stated that the inclusion of these clauses merely forces National Grid Gas to reassess the relevant parts of the UNC when the current provisions may be adequate.

The respondents who offered qualified support to the proposal generally had concerns regarding the use of sunset clauses. One respondent noted that National Grid NTS makes no reference in their modification proposal as to how DNs will procure long term exit capacity after 30 September 2010. The respondent believed that more work should be done to find a solution for long term DN offtake arrangements that are practical, simple and effective. For example, the respondent suggested that the sunset clauses could be extended for 10 or 15 years and that DNs could be required to use the ARCA based system indefinitely for signalling their capacity requirements as shippers currently do. Another respondent stated that their preferred approach would have been to see a rolling end date for this modification rather than the firm date of 30 September 2010.

One respondent offering qualified support considered that the extension rather than removal of sunset clauses gives rise to a number of issues. In particular, the respondent considered that it effectively prevents signalling the need for capacity beyond 30 September 2010, and it assumes that further changes to the arrangements are necessary. The respondent also expressed concerns that this modification is linked to a number of other documents.

Another respondent offering qualified support stated that it remained opposed in principle to the continued inclusion of a sunset clause in the UNC. The respondent noted that it would offer full support to the proposal if the process for firm capacity allocations was not end dated. The respondent stated that the continued application of a sunset clause means that parties do not have any certainty as to what arrangements might be in place after 30 September 2010. The respondent considered that this perpetuates regulatory uncertainty which in turn undermines competition in the shipping and supply of gas.

Safety case / security of supply comments

A number of respondents commented on the impact of the modification on security of supply. One respondent stated that discussions within industry have developed this proposal to a level whereby its implementation would ensure that NTS and DNs can better ensure security of supply. The respondent added that the absence of a UNC proposal in this area may result in DNs potentially breaching their Safety Case requirements.

Another respondent considered that the implementation of this modification enables the Transporter to comply with Safety Case obligations with respect to five year planning certainty and is consistent with the time periods National Grid NTS requires to ensure that DN offtake requirements can be delivered.

One respondent stated that without transitional arrangements a transporter's ability to ensure they can confidently continue to meet licence obligations to secure offtake capacity and meet peak demand will be severely restricted.

One respondent stated that this modification is urgently required because it ensures that DNOs are able to comply with their regulatory and safety obligations.

Calorific value data

One respondent stated that the timeframe for passing of information between the July-October window from 2006 onwards is likely to result in DNs using calorific value (CV) data provided from the previous October, while historically DNs have utilised equivalent data provided in May/June of the current year. The respondent added that examination of the relative accuracy of both sets of data (October and May/June) has indicated that decisions based on October data are likely to be no less or more accurate than those based on the previously used May/June data. The respondent further suggested that consistency of approach in this area may well be best served by transporters referencing this approach in the offtake communications document.

Capacity registration process and ARCAs

One respondent noted that shippers normally signal capacity requirements on shorter timescales than transporters and stated that there are many reasons why this is appropriate. However, the respondent noted that additional mechanisms exist outwith the capacity registration process to allow shippers and developers to reserve capacity over a longer timeframe. In particular, the respondent noted that shippers and developers can enter into an ARCA. The respondent added some specific comments on the appropriateness of ARCAs when extended to DNOs.

Another respondent welcomed the proposal not to change the current registration process for NTS directly connected sites and the ARCA process for incremental capacity requirements.

One respondent suggested that the legal drafting should make clear that all ARCAs should be subject to UNC governance and oversight by the UNC panel. The respondent added the ARCA terms could either be included in the UNC or the form of these ancillary documents should be subject to approval by the UNC Network Code Committee from time to time. In addition the respondent stated that, to avoid undue discrimination between NTS connectees, it is particularly important that ARCAs remain standard documents, and any future changes to ARCA terms are properly consulted on and are visible to all market participants. The respondent also stated that these documents should not be allowed to evolve into bilaterally negotiated agreements.

Related consultations

A number of respondents made reference to separate related consultations initiated by National Grid NTS (Standard Condition 4B statement, Incremental Exit Capacity Release (IExCR) methodology statement, DN and direct connect ARCAs).

One respondent recognised that supporting changes are required to the Standard Condition 4B statement and the interim and transitional IExCR. The respondent stated that, whilst these supporting changes are required, they will not alter this modification and therefore it is possible for users to recommend implementation before consultation of these changes has been completed.

On the contrary, another respondent was concerned that this modification is linked to a number of other documents (IExCR, Standard Condition 4B licence statement, DC and DN ARCA). The respondent stated that, while it is possible that the outcome of these consultations will not have a material impact on the modification itself, this could impact

participants' perception of this modification and the effect of the legal text, which could in turn affect their support for the proposal.

Other comments

Some respondents provided specific comments on the legal text.

Panel recommendation

At the modification panel meeting of 23 September 2005, of the eight voting members present, capable of casting ten votes, ten votes were cast in favour of implementing modification proposal 0046. Therefore the panel recommended implementation of the proposal.

Ofgem's view

Ofgem has carefully considered the views raised by all parties in relation to modification proposal 0046.

Having had regard to the principal objective and the statutory duties of the Authority, Ofgem considers that this modification proposal better facilitates the relevant objectives (a) and (b) as set out in paragraph 1 of Standard Special Condition A11 (Network Code and Uniform Network Code) in the Gas Transporter Licence.

Standard Special Condition A11(1) (a) – the efficient and economic operation of the pipe-line system to which this licence relates

Ofgem concurs with the view of the proposer that the proposal would better facilitate the efficient and economic operation of the NTS pipeline system by enabling DNO users to register their NTS/LDZ offtake capacity requirements beyond September 2008. This would allow National Grid NTS to undertake better informed investment decisions and thereby better facilitate the efficient and economic operation of the pipeline system.

However, it should be noted that Ofgem has a number of concerns with the proposal as it establishes separate capacity booking arrangements between DNs and shippers that act on behalf of NTS direct connects. In particular, only DNs would be required to make requests for capacity at the three year ahead stage whilst direct connect shippers are effectively guaranteed 'grandfathered' rights without the need to commit to buying capacity in the long term. This could be viewed as a proposal that maintains the potential for discrimination between DNs and shippers representing direct connects.

For example, the proposal does not enable DNs to access or compete for existing capacity held by shippers even though a DN may place a greater value on that capacity than an existing shipper supplying a direct connect. This may lead to DNs incurring higher costs in terms of booking capacity than may otherwise have been the case. In turn, this may distort the long term signals that the NTS receives from DNs in terms of capacity bookings under modification proposal 0046. For example, it may result in investment being signalled to National Grid NTS when such investment may not be necessary as there is surplus capacity in the network.

Ofgem would also note that the retention of 'grandfathered' firm capacity rights to existing shippers, may also lead to potential discrimination between new and existing users to the extent that where investment is necessary, new users are required to enter into ARCAs to enable them to access the NTS, whereas existing users are able to roll over their existing capacity requirements.

Despite these concerns, on balance Ofgem considers that this proposal is appropriate within the context of the transitional arrangements and on the basis that the sunset clauses are in place. However, Ofgem considers that for the reasons outlined above and without fettering the discretion of the Authority in relation to decisions on any future modification proposals, any enduring offtake arrangements that are developed should ensure that all users are able to secure offtake capacity under equivalent booking arrangements.

Standard Special Condition A11(1) (b) –so far as is consistent with subparagraph (a), the co-ordinated, efficient and economic operation of (i) the combined pipeline system and/or (ii) the pipe line system of one or more other relevant gas transporters

In view of the arguments outlined above, Ofgem considers on balance that this modification proposal better facilitates the coordinated, efficient and economic operation of the combined pipeline system. In particular, the proposal allows DNs to indicate their capacity requests to inform National Grid NTS's investment decisions beyond September 2008. Ofgem also however reiterates the concerns it has expressed above regarding the different capacity booking arrangements that this proposal establishes for DNs and shippers representing direct connects and the potential for different booking arrangements to create discrimination issues. For this reason, Ofgem considers that the retention of the sunset clauses is important so as to enable consideration to be given to the establishment of enduring offtake arrangements that address the concerns outlined in this letter.

Ofgem's decision

For the reasons outlined above, Ofgem has decided to accept modification proposal 0046.

If you wish to discuss any aspect of this letter, Mark Feather (telephone 0207 901 7437) or Matteo Guarnerio (telephone 0207 901 7493) would be pleased to assist.

Yours sincerely



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